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IN THE

Supreme Court of the United States

October Term, 1967
No. 357

MIRRO-DYNAMICS CORPORATION,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner hereby petitions this Court for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit.

Opinions Below.

The memorandum decision of the District Court is reported at 247 F. Supp. 214. The findings of fact and conclusions of law [R. 277-284] are not officially reported (Appendix A, *infra*). The opinion of the Court of Appeals (Appendix B, *infra*) is reported at 374 F. 2d 14.

Jurisdiction.

The judgment of the Court of Appeals was entered March 10, 1967. A timely petition for rehearing was denied by the Court of Appeals on April 20, 1967. Jurisdiction of this Court is based on 28 U.S.C. §1254 (1).

Questions Presented.

This is a federal income tax case involving refund suits for taxes paid for 1958, 1959, and 1960 fiscal years based on net operating loss carrybacks from 1961 and 1962 generated by Petitioner's business of buying and selling securities. A jury trial was timely demanded. The district court granted the Government's motion for summary judgment.

1. If in determining whether capital gain or ordinary income results and whether property is held primarily for sale to customers, Courts of Appeals have in cases involving securities and commodities improperly used criteria different from those used in cases involving real property.

2. Whether this Court's rule of law that the fruits of the everyday operations of a business yield ordinary income and loss is applicable to the business of buying and selling securities, even if the taxpayer is not entitled to inventory securities as a dealer within the definition of U.S. Treas. Reg. §1.471-5.

3. Whether this Court's rule of law that the fruits of the everyday operations of a business yield ordinary income and loss is applicable to the business of buying and selling securities, even if the taxpayer is not licensed as a broker-dealer.

4. Whether the issues as to Petitioner's intent in in the acquisition and disposition of securities and as to whether its sales of securities were in the everyday operations of its business were triable issues of material fact requiring denial of the Government's motion for summary judgment.

Statute Involved.

Internal Revenue Code of 1954, 26 U.S.C. §1221(1):

§1221. Capital Asset Defined.

> For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

Statement of the Case.

A jury trial was timely demanded in these three refund suits brought under 28 U.S.C. §1346(a)(1) for 1958, 1959, and 1960 fiscal years, which were consolidated for trial and decision.

The taxpayer, a California corporation, manufactured and sold sliding glass doors prior to April, 1961. In the spring of 1961 it sold substantially all of its assets for a cash consideration approximating one million dollars, discontinued the sliding door business, its then only business, and moved its offices. It then went into the business of buying and selling securities. The taxpayer's two principal officers devoted their entire time daily to the corporation's business of buying and selling securities, which was then its only business. At various times the taxpayer made attempts to acquire large blocks of stock with a view to effecting public distribution thereof and with a view to maintaining a market therein [R. 258].

During the 1961 year the taxpayer purchased a total of $3,023,313.91 worth of securities which were sold for $3,039,658.41 in hundreds of different transactions. During the 1962 year the taxpayer purchased and sold in the course of its business thousands of shares of stock in several hundred different transactions. Inventories were maintained of all of such securities. During the 1962 year taxpayer sold securities with a cost of $4,944,582.49 for $4,038,721.02.

During 1961-62 taxpayer was actively, directly, and continuously engaged in the business of buying and selling securities for cash and on margin, dealing in puts and calls, and selling short. Not all of these transactions were effected through brokers. They were all effected for the taxpayer's own account as a principal. At no time did taxpayer purchase or sell securities with an investment motive.

The taxpayer was not a broker, did not solicit orders by advertising from the public, and was not licensed as a broker-dealer. At various times taxpayer's officers dealt directly with other principals.

The claims for refund for 1959 and 1960 are primarily premised on a net operating loss carryback generated by the 1962 $905,861.47 loss in the securities' business and a deduction for federal transfer taxes of $1,592.60.

Of the foregoing facts, only a few immaterial ones were undisputed or found as facts by the district court. None was stipulated to, as there was no stipulation of facts or pre-trial conference order. There was no trial.

Without any finding of fact as to what plaintiff's business was during 1961-62, other than the subsidiary

finding that plaintiff purchased and sold securities solely for its own account [Finding of Fact 14, App. A, *infra*], the district court granted the Government's motion for summary judgment on the ground that plaintiff's securities were not inventories under 26 U.S.C. §471, plaintiff was not a dealer in securities under U.S, Treas. Reg: 1.471-5, and therefore the securities were capital assets generating a capital loss which cannot be carried back [Concl. of Law 2, 4, 3, App. A, *infra*]. No reference is made to the district court's memorandum opinion as this Court has stated that it is "not at liberty to refer to the opinion for the purpose of eking out, controlling or modifying the scope of the findings." *Stone v. United States,* 164 U.S. 380, 383.

The Court of Appeals affirmed based on its interpretation that since the taxpayer was not *licensed* to sell securities to the public, it was not "a dealer with customers to whom it could sell securities in the ordinary course of its business," and "this disability prevented taxpayer's assets from coming within the exceptions to §1221(1), specifically the phrase requiring the property to be held 'for sale to customers.'"

Reasons for Granting the Writ.

Despite the fact that this Court has repeatedly stated that the words in the Internal Revenue Code should be construed in their ordinary and not in an artificially created, meaning, courts of appeals are in conflict and confused in their interpretation not only of the verbiage in §1221(1) of the Internal Revenue Code of 1954, but also in the relationship of the exclusionary clauses *inter sese.*

The reasons for the grant of certiorari are bottomed on conflicts in the circuits with respect to two issues in the interpretation of §1221(1) and its predecessor §117:

1. Whether property held primarily for sale to customers in the ordinary course of a trade or business is excluded from capital assets without regard to whether the property is inventoriable stock in trade under the first exclusion.

2. Whether the phrase "held primarily for sale to customers" must be subject to a consistent interpretation without regard to the nature of the property involved.

The erroneous resolution of these issues below was the basis for the rulings in the Government's favor.

I.

§1221(1) provides for two exclusions from capital assets: one for stock in trade constituting inventory and a second exclusion for property held primarily for sale to customers in the ordinary course of a trade or business. The plain meaning of these provisions is that the term capital assets excludes property constituting stock in trade or other inventoriable property, and as a separate item the term capital assets excludes property held by the taxpayer primarily for sale to customers in the ordinary course of trade or business. The Government has argued from time to time that only property meeting **both** of these requirements will be excluded from capital assets. The district court in the case at bar ruled, on the Government's motion for summary judgment, that the taxpayer's securities were not inventory or inventoriable under 26 U.S.C. §471, be-

cause the taxpayer was not a merchant-dealer in securities as defined in U.S. Treas. Reg. §1.471-5 (1958), and therefore the taxpayer's activities in securities generated a capital loss. There was no finding of fact or conclusion of law directed to the issue of whether the securities were primarily held for sale under the second exclusion or whether the taxpayer's business of buying and selling securities generated ordinary income and loss (App. A, *infra*).

Instead of basing its conclusions on cases defining the phrase "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business," the district court based its conclusion on a decision of this Court relating to whether taxpayers fit the dealer definition contained in predecessor Treasury regulations substantially similar to §1.471-5, in which taxpayers sought to inventory securities and price inventories thereof on the basis of cost or market, whichever is lower. Such inventory pricing would allow for the deduction of unrealized losses in a declining securities' market without the securities having been sold. *Schafer v. Helvering*, 299 U.S. 171 (cited in Concl. of Law 2, App. A) and its companion case *Helvering v. Fried*, 299 U.S. 175, held in effect that "a specialist" on the floor of the N.Y. Stock Exchange could inventory those stocks in which he was a specialist, that he was a merchant-dealer in securities as to those securities as defined by U.S. Treas. Reg. 74, Art. 105, and could therefore price inventories thereof at cost or market, whichever is lower. Neither of these cases involved the issue of whether the securities constituted capital assets. Nevertheless, the Government has used the merchant in securities' con-

cept and cited these cases and the inventory regulations as support for its contention in this and other cases that certain securities were not capital assets within the meaning of the second exclusion. As a result circuit courts have been in conflict in this area.

In *United States v. Chinook Investment Co.*, 136 F. 2d 984 (9th Cir. 1943), the court said that the regulation defining who was an inventory dealer in securities was irrelevant to such an issue; whereas "The case of *Commissioner v. Burnett*, 5 Cir., 118 F. 2d 659, appears to support the view that the regulation is controlling." (136 F. 2d at 985). The Government's position that Congress intended the applicability of the second exclusion "to merchants or dealers in securities" was sustained in *Warren Co. v. U.S.*, 53 F. Supp. 578, 581-2 (D. Mass. 1944); *G. R. Kemon*, 16 T.C. 1026 (1951); see *F. S. Farr*, 44 B.T.A. 683; 689 (1941).

Although the district court in this case should have been bound by the *Chinook* decision in the Ninth Circuit and should have disregarded the dealer inventory section of the regulations, §1.471-5, which by its terms limits its definition of dealers to "the meaning of this section", in determining whether the second exclusion was applicable, it nevertheless ruled that the *Schafer* case and Reg. §1.471-5 compelled the conclusion that the taxpayer's business generated capital gain and loss. The Court of Appeals below made no comment on this ruling.

To resolve this conflict, this Court should determine whether the rationale of the *Chinook* case is correct and whether securities held primarily for sale to customers may be excluded from the definition of capital assets whether or not they constitute inventory in the

hands of a merchant-dealer in securities as defined in the regulations relating to inventories. The First Circuit held with respect to a like provision of the Revenue Act of 1926 in *Gilbert v. Com'r,* 56 F. 2d 361, 362 (1st Cir. 1932) based on Rep. No. 179, 68th Cong. 1st Sess. 19 [1939-1 Cum. Bull. (part 2) 281]:

> "It is a well-settled rule of construction that a statute should, if possible, be so construed as to give meaning to all parts of it. Stock in trade and inventory property having been covered by the first two classifications, the final provision was evidently intended to cover something else. It included in our opinion all property which was owned by the taxpayer in connection with his business and held primarily for sale, but which was not stock in trade or part of the inventory."

II.

The Government has attempted to inject further uncertainty and ambiguity into the plain words of the statute by contending for one interpretation of the second exclusion if the "property" is securities or commodities and another for other property such as real property or patents. This unjustified dichotomy turns on the use of the words "to customers" in this exclusion. Almost each word in this exclusion has required this Court's interpretation, but this Court in each such opinion has reiterated that the common, ordinary meaning should be attributed to these words in the absence of ambiguity or a limiting definition.

The Solicitor General before this Court in *Malat v. Riddell,* 383 U.S. 569, contended on brief (pp. 29-30) in response to the taxpayer's contention that a sale of

real property between joint venturers was not a sale to customers in the ordinary course of business:

> "The courts have long held that anyone engaged in the business of selling property sells it to customers whenever he finds someone who will purchase it. In one frequently cited case the Board of Tax Appeals held that:
>
> > Where, as here, one is regularly engaged in the business of buying and selling real estate, as was petitioner, any person who can be found to buy such property is a customer, as that term is ordinarily understood, and where such property is held for sale under such circumstances it must be deemed to be held for sale to customers within the meaning of the statute. [*Black v. Commissioner,* 45 B.T.A. 204, 210.]
>
> As Judge Learned Hand stated the same principle, those "whose custom the taxpayer seeks*** are his 'customers.' " *Goldsmith v. Commissioner,* 143 F. 2d 466, 468 (C.A. 2), certiorari denied, 323 U.S. 774. See also *Gamble v. Commission,* decided October 27, 1955 (P-H Memo T.C., para. 55,289, affirmed, 242 F. 2d 586 (C.A. 5) ("one engaged in the continuous purchase and sale of property, as this petitioner was, has dealings with a 'customer' whenever he sells."); *Pennroad Corp. v. Commissioner,* 261 F. 2d 325, 330 (C.A. 3), certiorari denied *sub nom. Madison Fund, Inc. v. Commissioner,* 359 U.S. 958; *Stockton Harbor Industrial Co. v. Commissioner,* 216 F. 2d 638 (C.A. 9), certiorari denied, 349 U.S. 904. Cf. *Watson v. Commissioner,* 345 U.S. 544."

In the Court of Appeals in the case at bar, the Department of Justice attempted to explain away the Solicitor General's position in *Malat* by arguing as follows: the legislative history of the addition of the words "to customers" indicated otherwise where securities are concerned, "Since stock market speculators sell a fungible item to buyers they never see, Congress believed that requiring a sale to be not merely 'in the course of a business' but also 'to customers' would exclude them." Even assuming that Congress so erroneously believed, such reasoning is fallacious since the fact that property is fungible does not bear on whether it is a capital asset and since the further fact that whether the seller knows the identity of the buyer also does not bear on whether it is a capital asset (see *Pool v. Com'r*, 251 F. 2d 233, 246-7 (9th Cir.), *cert. denied*, 356 U.S. 938). In any event, this Court has repeatedly rejected attempts to create an ambiguity in statutory language based on legislative history or committee reports. *Malat v. Riddell, supra.* In *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85, 89, this Court held that it was "not at liberty to construe or to refer to committee reports where there can be no doubt of the meaning of the words used." Even though the legislative history indicates that the desire of Congress was to prevent speculators selling securities at a loss from taking ordinary rather than capital losses and the words "to customers" may have been added with the express purpose of accomplishing this result (H. Conf. Rep. No. 1385, 73d Cong., 2d Sess. p. 22 [1939-1 Cum. Bull. (part 2) 632]), the plain meaning of "to customers" belies this interpretation. **A "customer" is anyone who buys from a taxpayer.**

§1221 refers to property HELD by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. This refers only to the purpose for which the property was held. It does not refer to the purchaser. Thus, if the property was *held* primarily for sale to customers—that is, if the taxpayer *held* the property for sale to anyone who would buy it, it is unnecessary to look to the manner in which it was ultimately sold and whether it was sold to a buyer face to face or through an exchange. The crux of the question is—was it primarily held for sale or was it being held as an investment?

Patently there is no limitation in the statute bearing on the nature of the property involved. *Cf. United States v. Chinook Inv. Co. supra* at 985. A limitation cannot be written into the revenue laws merely because a committee report suggests such action. *Com'r v. Cannon Valley Milling Co.*, 129 F. 2d 642, 645 (8th Cir. 1942). As the late Mr. Justice Jackson has pointed out:

> "It is the business of Congress to sum up its own debates in the legislation. Moreover, it is only the words of the bill that have presidential approval, where that approval is given. It is not to be supposed that in signing a bill the President endorses the whole Congressional Record. For us to undertake to reconstruct an enactment from legislative history is merely to involve the Court in political controversies which are quite proper in the enactment of a bill but should have no place in its interpretation." *Schwegmann Bros. v. Calvert*, 341 U.S. 384, 396.

This Court's decisions make it plain that in dealing with a tax statute, it is not the business of the judiciary to restrict the application of the legislative text when Congress failed to do so. *Lewyt Corp. v. Com'r,* 349 U.S. 237; *Com'r v. Korell,* 339 U.S. 619, 628; *United States v. Merriam,* 263 U.S. 179, 187. The word customers cannot have a meaning depending upon the property involved.

Even those circuits which have attempted to find some special meaning in the word "customers" have achieved conflicting results. In *Faroll v. Jarecki,* 231 F. 2d 281, 287 (7th Cir.), *cert. denied,* 352 U.S. 830, "inter-member transactions in commodity futures operating in the 'pit'" were not considered sales to customers. In *Stokes v. Rothensies,* 61 F. Supp. 444, *aff'd per curiam,* 154 F. 2d 1022 (3rd Cir. 1946), a "group of securities dealers and brokerage houses" were considered customers to whom the taxpayer sold "without distinction." On the other hand, the Ninth Circuit in *Pool v. Com'r, supra* at 242, suggests, in reliance on *Gruver v. Com'r,* 142 F. 2d 363 (4th Cir. 1944), that there is no valid reason for not applying the same concepts to real property as are used for securities. Although not cited in the *Pool* opinion, the *Chinook* case, *supra,* appears to reach the same conclusion. However, the Court of Appeals below bottomed its opinion on the fact that the taxpayer was not licensed as a broker-dealer by state or federal authorities and, therefore, concluded as a matter of law that it could not have had any customers, without knowing or stating whether or not the taxpayer had customers legally or illegally. There is nothing in this record to show the extent of customer activity in connection with the sale

of millions of dollars worth of securities in hundreds of different transactions. Had these securities been parcels of real estate there is no doubt that the Government would concede ordinary income and loss treatment therefor without regard to customer activity, based on a substantial body of decisions.

There is a further judicial difference in approach where real property is concerned, in that courts have generally looked to the continuity and frequency of transactions and then concluded that a taxpayer was a dealer as a shorthand characterization that his sales generated ordinary income. On the other hand, where securities are concerned, courts have attempted to characterize the status of the taxpayer as dealer, trader, or otherwise, rather than the status of the assets in the hands of the taxpayer. Compare *United States v. Chinook Inv.*, 136 F. 2d 984, 985 (9th Cir. 1943), with *Faroll v. Jarecki*, 231 F. 2d 281, 287 (7th Cir.) *cert. denied* 352 U.S. 830, and *Com'r v. Burnett*, 118 F. 2d 659 (5th Cir. 1941). Although use of the term dealer or merchant in securities is dictated by the regulations for the purpose of determining whether a taxpayer may inventory securities, **neither § 1221(1) nor the operating loss provisions nor the regulations thereunder use or define "dealer."** The Code does not provide that only dealers in securities are entitled to ordinary losses. The clear words of the statute and this Court's decision in the *Malat* case show that it is each asset coupled with the intent and purpose for which it is held which a court must look to in determining capital gains treatment, rather than the status of the taxpayer. There is nothing in the statute suggesting a difference in treatment or approach

depending on the nature of the property. If the taxpayer's activities are of sufficient frequency and continuity to rise to the status of a business, that is enough to exclude him from the capital asset provisions. *Pool v. Com'r, supra; Field v. Com'r,* 139 F. 2d 465, 469 (2d Cir. 1943).

A like problem is presented in *Reinach v. Com'r,* 373 F. 2d 900 (2d Cir.) [Pet. for Writ of Cert. filed June 26, 1967, No. 292], in which the issue concerns the tax treatment to be afforded losses on short sales incurred in the taxpayer's business of writing put and call options.

An interpretation of the statutory provisions ignoring the nature of the property is consistent with the decisions of this Court excluding from the ambit of the capital gains provisions the "profits . . . arising from the everyday operation of a business." *Corn Products Co. v. Com'r,* 350 U.S. 46, 52, *reh. denied,* 350 U.S. 943. Both the majority opinion by Justice White and the dissent by former Justice Goldberg in *Com'r v. Brown,* 380 U.S. 563, 572, 584, are premised on the statutory provisions not "being designed to allow capital gain treatment for the recurrent receipt of commercial or business income." Such a policy of narrowly construing what are capital assets (*Id.* at 570) cannot be subverted by a restrictive reading as to who customers are.

To resolve not only the difference in treatment urged by the Government, but also the conflict in the circuits as to what the phrase "held primarily for sale to customers" means, certiorari should be granted.

III.

The Ninth Circuit's opinion (App. B) said not one word about the propriety or impropriety of the lower court's having granted a motion for summary judgment instead of requiring a trial of the issues of fact. The opinion proceeds to discuss the legal points involved with blithe disregard of the fact that the taxpayer has never had an opportunity to present the facts of the case to the jury or any court. In petitioner's brief below, there were five Specifications of Error with respect to the district court's having granted defendant's motion for summary judgment and having failed to make any finding or conclusion as to whether there were or were not any genuine issues of material fact to be tried, and yet no mention at all was made by the Ninth Circuit on the question of the impropriety of granting a motion for summary judgment.

It seems clear that the scope of the taxpayer's business and the question as to the purpose for which the securities were held are questions of fact and that the taxpayer should have been allowed to have its day in court to prove to a jury that the securities which it sold were property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.

Although §1221(1) expressly excludes inventoriable stock in trade and property held by the taxpayer primarily for sale from the definition of capital assets, the lower court's Conclusions of Law (App. A, *infra*) provide that "The securities purchased and sold by the plaintiff during fiscal years ended Oct. 31, 1961 and Oct. 31, 1962 are capital assets within the meaning of Title 26 United States Code 1221" and are not "business inventories." Presumably this inferentially in-

cludes a conclusion of law that these securities were not property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. However, such an inference cannot properly be drawn without a finding of fact as to whether the securities were held by the taxpayer primarily for sale to customers in the ordinary course of business. No such finding was made, although it is clear that the issue as to the taxpayer's intent in holding the securities is a question of fact, not to speak of the issue of what the ordinary course of the taxpayer's business was (*i.e.*, what was plaintiff's everyday operation of its business, and what activities did plaintiff engage in in pursuit of its business of buying and selling securities?).

Instead of determining that there are triable issues of material fact, the lower court granted the motion, which was based on the pleadings and the affidavit of the Asst. U.S. Attorney who represented the Government in the lower court in the defense of this case. This affidavit was insufficient under Fed. R. Civ. P. 56(e), not being based on the personal knowledge of the affiant. Since a determination of the extent of the taxpayer's activities and its intent and motive in buying and selling securities is essential to a decision in this case, there is no doubt that there were genuine triable issues of material fact compelling denial of the motion for summary judgment even if the affidavit had been sufficient. The district court should have merely determined that there were triable issues of fact rather than purporting to decide those issues based on the insufficient record before it. *Poller v. CBS*, 368 U.S. 464, 473; *Kennedy v. Silas Mason Co.*, 334 U.S. 249, 256.

In light of this Court's repeated narrow construction of the capital gains provisions affording "capital gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time" (*Com'r v. Gillette Motor Co.*, 364 U.S. 130, 134), and excluding profits arising from the everyday operation of a business, there is no doubt that the district court without foundation improperly drew inferences in granting the motion. See *United States v. Diebold, Inc.*, 369 U.S. 654, 655. As Mr. Justice Stewart so aptly put it in his dissenting opinion in *Simpson v. Union Oil*, 377 U.S. 13, 25: "the root error in this case, it seems to me, was the District Court's decision to terminate the controversy by way of a summary judgment."

Conclusion.

To resolve a conflict between Courts of Appeals, District Courts, and the Tax Court in the interpretation and administration of the revenue laws, this petition for writ of certiorari should be granted. From the number of times this Court's opinions in the *Schafer* and *Corn Products* cases have been cited, both properly and improperly, it is quite apparent that considerable confusion persists. Such chaos can be eliminated only by an opinion of this Court. The terms involved are still in the Internal Revenue Code, so that the issue remains as one of importance and could have a considerable effect on the public fisc.

Respectfully submitted,

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